

Smarter regulation and the regulatory landscape: Department for Business and Trade Consultation

Wednesday 17 January 2024

Submitted via the DBT online submission form

Response to consultation questions

Question 1: Based on your experience, do you think that UK regulators are supportive of the individual businesses they regulate in a way that appropriately balances considerations of consumers and other businesses within the sector more broadly?

In our experience within the internal audit sector and through close observation of the UK's regulatory framework, we recognise that UK regulators, including the Financial Reporting Council (FRC), generally aim to support the businesses they regulate. However, we would like to use this consultation as an opportunity to highlight that at present, the FRC lacks the statutory powers it needs to be able to regulate smartly and effectively.

The FRC's lack of statutory powers restricts its efficacy in holding company directors and audit firms accountable. This limitation not only directly impacts businesses but also affects investor confidence, which is key for the health of the economy. Recent corporate failures linked to audit and governance weaknesses have underlined how deficiencies in the regulatory system can undermine investor trust and have detrimental impacts on the wider economy in terms of hurting jobs and growth.

Putting the audit regulator on a statutory footing with the legal powers it needs to do its job properly, as well as improving corporate governance and reporting, are essential not just in terms of helping to prevent corporate collapses but also for safeguarding investor interests. Investors play a vital role in the economic ecosystem, and their confidence is paramount for the stability and attractiveness of the UK market. Ensuring the robustness and integrity of audit, governance and corporate reporting is key to maintaining this confidence.

The government's approach to deregulation, while aimed at enhancing market attractiveness, should not overlook the necessity for stronger audit, governance and accountability. Contrary to the view that proposals such as the new corporate reporting requirements for larger public and private companies to publish an Audit and Assurance Policy and a Resilience Statement are merely 'red tape', these measures are, in fact, vital for streamlining and improving current reporting practices.

The proposal for a Resilience Statement, far from adding unnecessary burden, actually aims to consolidate the existing going concern and viability statement. This is a move towards more efficient, purposeful, and integrated reporting, rather than an increase in obligations. Similarly, the requirement for an Audit and Assurance Policy, which is only required to be published and updated once every three years, is a reasonable expectation that should not be seen as burdensome or excessive. These reforms are steps towards enhancing transparency and bolstering investor confidence. They represent a balanced and proportionate regulatory approach, safeguarding the interests of both businesses and

investors. Such measures are essential in fostering sustainable growth and ensuring the long-term success of UK businesses in the competitive global economy.

While UK regulators strive to support the businesses they oversee, a more nuanced approach is required to adequately balance the considerations of both businesses and investors. Enhancing regulatory frameworks in areas such as audit, corporate governance and financial reporting is crucial for this balance, promoting a healthy, transparent, and resilient business environment.

Question 2: Please name the UK regulator(s) you engage with most frequently:

Most Frequently: **Financial Reporting Council (FRC)** Frequently: **Financial Conduct Authority (FCA), Prudential Regulation Authority (PRA), Ofgem, Ofqual and the Charity Commission.**

Question 3: What do you consider to be the most positive and/or negative aspect of how the UK regulators that you engage with operate?

We have a strong, constructive and positive relationship with the Financial Reporting Council (FRC) and their executive leadership team proactively engage with us regularly. We believe they are doing the best job they can within the scope of their duties and with the powers they currently have. However, their most significant negative aspect as a regulator is its lack of statutory powers. This limitation hinders its ability to act when financial misreporting, audit and corporate governance failures occur. Enhancing the FRC's legal authority is imperative for effective regulatory oversight.

Six years after the collapse of Carillion and after multiple independent reviews on audit and corporate governance in the UK, the FRC still doesn't have the statutory powers it needs to be an effective regulator. This deficiency has been highlighted in Sir John Kingman and Sir Donald Brydon's final reports and associated recommendations, both underlining the urgent need for primary legislation to empower the FRC. The government's delay in enacting such legislation hinders the FRC's effectiveness in promoting high standards of audit, reporting, and corporate governance. This calls for immediate action to give the FRC the necessary powers, as recommended in the white paper 'Restoring trust in audit and corporate governance'.

In contrast, our interactions with Ofqual, as a provider of education and training in the internal audit profession, have been notably positive. Ofqual's requirements and processes have been manageable, fair, and proportionate, reflecting well on their regulatory approach. Regular activities, including annual compliance statements and data requests, are conducted efficiently, maintaining a good level of oversight without being burdensome. However, we note that an increase in the frequency of these requests could become onerous. We recommend that Ofqual continues to refine and streamline its reporting processes for education and training providers, ensuring that regulatory demands remain reasonable and proportionate, so as not to impede the delivery of our services.

Our engagement with Ofgem presents a mixed experience. Initially, in 2019/20, our attempts to engage with them regarding our Internal Audit Code of Practice were unsuccessful, despite several communications to the office of their Chief Executive. This changed in 2022, following the collapse of 30 energy suppliers, when we wrote to their Chief Executive, Jonathan Brearley, about our concerns regarding the internal audit capabilities of energy providers. Ofgem's response was swift, leading to a productive meeting about our concerns.

We now view our relationship with Ofgem as positive and constructive.

Question 4: Based on your experience or understanding of UK regulators, do you find it clear what the overall purpose and objectives of individual regulators are?

The Financial Reporting Council's (FRC) effectiveness is significantly undermined by the lack of primary legislation to put it on a statutory footing with the legal powers it needs to do its job properly, constraining its ability to fully achieve its objectives. This limitation contrasts with the capabilities of other regulators we regularly engage with like the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), which have comprehensive statutory powers. The PRA and FCA operate with clear legal mandates, demonstrating a more effective regulatory model, with the authority to enforce compliance and ensure financial stability.

The FRC needs similar statutory authority to be effective. A proportionate enhancement of these powers would clarify and strengthen the FRC's role, enabling more effective governance and accountability, without leading to excessive regulatory control. This comparison underscores the urgent need for legislative action to empower the FRC, making it more effective in serving the public interest and ensuring integrity in audit and corporate governance. The current regulatory gap indicates that the framework for audit, corporate reporting, and governance regulation in the UK may not be fit for purpose. By equipping the FRC by putting it on a similar statutory footing to the PRA and FCA, it can more effectively fulfil its mandate in serving the public interest.

Question 5: Within these overall objectives (as considered in the preceding question), do you find it clear what the specific statutory duties (i.e. required by legislation) of individual UK regulators are?

Yes, we believe the statutory duties of the majority of regulators we engage with are clear, especially financial regulators such as the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The Financial Reporting Council (FRC) however is currently operating without the necessary statutory powers, unlike the PRA and the FCA which have all the statutory powers they need to effectively regulate the financial sector. The FRC's lack of powers severely limits its ability to regulate and enforce standards in the UK corporate governance and auditing sector. This deficiency undermines the FRC's role as a regulator and impedes its ability to hold audit firms and company directors accountable. Granting the FRC statutory powers is essential for it to effectively fulfil its specific duties and to strengthen the UK's audit and corporate governance framework for the health of the wider economy and in protecting jobs and growth.

Question 6: Do you think that the statutory duties (i.e required by legislation) imposed on UK regulators:

- 1. *Cover the right issues?***
- 2. *Are clearly stated in the relevant statute, including where supplemented by relevant guidance? and***
- 3. *Are sufficiently consistent across regulators, where this is relevant?***

The current statutory duties imposed on the Financial Reporting Council (FRC) are not sufficient, significantly undermining its capacity to regulate effectively. The lack of statutory powers restricts the FRC from properly enforcing audit standards and ensuring corporate

accountability; this is detrimental to the quality and integrity of financial reporting and broader government objectives for a stable business environment.

One essential statutory power that the FRC urgently requires is the ability to sanction company directors, not just Chartered Accountants. The FRC should have a range of sanctions available, including disqualification, which may be applied to directors in respect of accountancy and transparency failings. This should be a statutory power. We also support this applying to all directors of a company, reflecting the joint and several, collective responsibilities of all company directors. January 2024 marks six years since the collapse of Carillion and it is a poignant reminder of the pressing need for audit and corporate governance reform in the UK. Carillion, then the UK's second-largest construction company, exposed weaknesses in the UK's audit and corporate governance framework. It was revealed that the directors of Carillion had been over-optimistic in their financial assessments, leading to massive debts and unmanageable contract obligations. Despite these issues, the company continued to declare dividends and high executive pay, raising questions about the effectiveness of its internal controls and the role of its directors.

The ability to impose sanctions on directors would significantly enhance the FRC's regulatory effectiveness, aligning its powers with broader objectives of corporate accountability and transparency. The Independent Reviews by Sir John Kingman and Sir Donald Brydon, along with the UK Government's white paper, have highlighted this need. Effective regulation in the audit sector extends beyond overseeing accountants to include those responsible for the wider corporate governance of companies. Without the ability to hold company directors accountable, the FRC's efforts in upholding standards are limited. When granting these powers, however, it is vital to ensure they proportionately cover the right issues and are articulated clearly. Every regulator must maintain a balance that deters malpractice in their industry while fostering a conducive environment for business innovation and one that supports the UK's economic competitiveness.

Question 8: Do you often have to engage multiple UK regulators on the same issue or area?

Yes, the Chartered IIA is actively engaging with UK regulators like the Financial Reporting Council (FRC), Ofgem, and the Charity Commission on the necessity for companies to have internal audit capability in regulated sectors or sectors that are of systemic importance to the operation of the economy. We have plans to extend these discussions to Ofwat and the Payment Services Provider regulator. Our engagement with Ofgem in November 2022 was particularly notable, where we expressed concerns about the absence of internal audit requirements for energy suppliers. Our comprehensive research on thirty energy suppliers that had recently gone bankrupt, including Bulb, the UK's seventh-largest supplier at the time, revealed that none had any internal audit capability as far as we could tell. We believe a strong, competent and appropriately resourced internal audit function is crucial in helping to mitigate organisational risks and safeguarding assets, reputation, and long-term sustainability.

Following our correspondence, which attracted media attention on the front page of the Financial Times' website, we met Ofgem's Director of Enforcement and Emerging Issues in February 2023. We proposed enhancements to Ofgem's Financial Responsibility Principle to closely align with the current requirements of the UK Corporate Governance Code on internal audit provisions. Ofgem responded positively, updating its principle so that energy suppliers now have to report on their internal audit capability, and if they don't have it then explain how they achieve adequate assurance, as well as review annually whether or not to

have an internal audit function.

Our experience with Ofgem demonstrates the broader issue of regulatory silos and the need for more cohesive frameworks and improved communication among regulators like Ofgem, the FRC, PRA, FCA and others. The case of energy suppliers, juxtaposed against the backdrop of corporate collapses linked to audit and governance weaknesses, such as BHS, Carillion, Patisserie Valerie, Thomas Cook and Wilko, highlights the importance of the presence of strong internal audit functions and the necessity for regulators to collaboratively ensure these practices are adopted more widely and are effectively monitored. A proportionate regulatory framework that avoids duplications and reduces burdens, while ensuring comprehensive risk management, effective internal controls and independent oversight, is critical for a healthy and sustainable business operating environment.

Question 11: Do you consider there to be underregulated areas of the economy or gaps in regulatory responsibility between UK regulators?

There is a significant regulatory gap for the Financial Reporting Council (FRC), currently operating without the necessary statutory powers. This severely limits its ability to regulate and enforce appropriate standards in audit and corporate governance.

Additionally, the Chartered IIA identified a regulatory gap in the charity sector regarding the absence of clear guidance on the necessity of internal audit functions. Through our advocacy efforts and discussions with the Charity Commission, we successfully influenced an update in their guidance on internal financial controls for charities. This update now incorporates references to the Global Internal Audit Standards and the Chartered Institute of Internal Auditors' Internal Audit Code of Practice. This revision emphasises the critical role of internal audit functions in evaluating financial controls, identifying, and managing risks, and offers detailed guidance for charities to establish effective internal audits and audit committees, tailored to their size and complexity. This development represents a proportionate response to the identified regulatory gap, enhancing the audit, governance, and accountability standards within the charity sector.

Question 13: Do you find UK regulators to be agile and responsive to new and emerging issues?

UK regulators, including the Financial Reporting Council (FRC), show responsiveness to new and emerging issues, but their effectiveness is often limited by structural and statutory constraints. The case of Carillion's deficient statutory audits, where fines were imposed nearly six years after the firm's collapse, is a prime example of a reactive, rather than proactive, regulatory approach. This delay in response underscores a broader issue that extends beyond the FRC to the government itself.

A proportionate approach to granting statutory powers where appropriate is crucial for regulators to respond swiftly and effectively to emerging issues. The agility of the government itself in empowering regulators grappling with new challenges is equally important. A dynamic and responsive approach when updating regulatory frameworks and empowering bodies like the FRC is vital. This will enhance the effectiveness of regulators and reflect a government-wide commitment to addressing emerging issues in a timely and effective manner. While UK regulators have the potential to be agile and responsive, their capabilities are often hindered by delayed governmental actions and legislative limitations. Therefore, both the agility of regulators and the responsiveness of the government to empower these regulators are pivotal in managing new and emerging challenges in the

corporate world – ensuring a joined-up and consistent approach.

Question 18: Do you think UK regulators are appropriately resourced to discharge their duties?

Yes, we believe that the majority of the regulators that we engage with have the resources they need to discharge their duties, especially financial regulators like the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). Previously, the Financial Reporting Council (FRC) lacked the resources to discharge its duties, but this changed after Sir John Kingman's Independent Review of the Financial Reporting Council and has since then been allocated more staff and resources. However, unlike the FCA and PRA, while the FRC does now have the resources to carry out its duties effectively it remains constrained by the absence of the necessary statutory powers. This limitation restricts its ability to discharge its duties fully and to enforce compliance with the high standards of audit, reporting and governance that it is tasked to uphold.

Question 42: Are there any further points you would raise about regulation, including the functioning of the regulatory system or any recommendations you have on the stock of regulations from the Government which should be removed or reformed and modernised?

A key area for regulatory reform is the Companies Act, specifically the reintroduction of the new corporate reporting requirements. The introduction of the Audit and Assurance Policy and the Resilience Statement are pivotal for modernising audit and corporate governance in the UK. These reforms are not about creating more red tape; rather, they are about ensuring businesses are more transparent, accountable, and prepared for future challenges.

Implementing the Audit and Assurance Policy requirements enables companies to communicate their audit and assurance systems and processes to stakeholders. Updated only once every three years, this policy will enhance investor confidence by providing a transparent view of how companies maintain and improve their audit and assurance systems and processes, focusing not just on compliance but on continuous improvement in governance. The need for companies to produce a Resilience Statement requires companies to robustly assess and disclose their resilience against their major short, medium, and long-term risks. In addition, the proposal for a Resilience Statement consolidates and builds on the existing going concern and viability statements, streamlining and consolidating existing reporting requirements. This approach does not add to reporting burdens but encourages companies to proactively manage risks thereby reducing the likelihood of unexpected business disruptions.

These enhancements to the corporate reporting framework are designed to be practical, proportionate and beneficial for businesses. Far from being burdensome, these reforms promote a smart and forward-looking approach, aligning UK businesses with global best practices in audit, corporate governance and risk management. Coupled with empowering the Financial Reporting Council (FRC) with statutory powers, these measures will strengthen the UK's regulatory system, making it more suited to the modern corporate world, without imposing unnecessary burdens.

Question 43: In what capacity do you interact with UK regulators or regulated businesses?

- Other – Professional Membership Body



Question 44: If you are a business, how many employees do you have?

- 10 – 49 employees

Question 45: Please name the Sector(s) that you operate in - you may wish to reference Standard Industrial Classifications

Professional Membership Body / Not-for-profit / professional services